

State Participation, Revenue Management and Local Content

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STATE PARTICIPATION

Learning Objectives

To understand

- Different Models for State Participation
- The reasons for having a National Oil Company
- The pros and cons of National Oil Companies
- The key choices for the NOC mission
- Different governance models for NOCs

Why have an NOC?

Questions to Ask

1. What is the national development agenda?
2. What is the role of the oil and gas sector in the national development agenda?

Direct state participation, typically via a National Oil Company, is the norm when the oil and gas sector is believed to be key to national development

Pros and Cons of NOCs



- Safeguard against dependence on IOCs
- Optimize resource development
- National control
- Allows sole risk
- Develop management and technical expertise
- Source of foreign currency
- Support of local service sector
- Control over operational decisions
- Direct country access to rent
- Could be catalyst for cost reduction
- Control reservoir management
- Help implement OPEC policies



- « State within a state »
- Development of oil and gas industry slowed by bureaucratic processes
- Discourage IOC activity
- Becomes a drain on resources by investing in un-economic/risky projects
- Protects an inefficient support of private sector
- Lower exposure to global industry trends and technology
- Conservative strategy and investment

KEY NOC Choices

NOC Choice	Options		
Mineral Rights	Exclusive		Shared
Upstream Regulatory Responsibility	None	Some	All
State Ownership	100%	Majority	Minority
Number of NOC's	Single		Multiple
Mission	Narrow Commercial		Wide National
Value Chain	Upstream	Midstream	Downstream
Geography	National	Regional	International
Capital Budget	Through Government Budget	Own Balance Sheet Corporate Debt	Own Balance Sheet Corporate Debt and Public Equity
Risk Tolerance	Low – carried interests only	Development Risk	High - exploration & development Risk

NOC Governance – Board Models

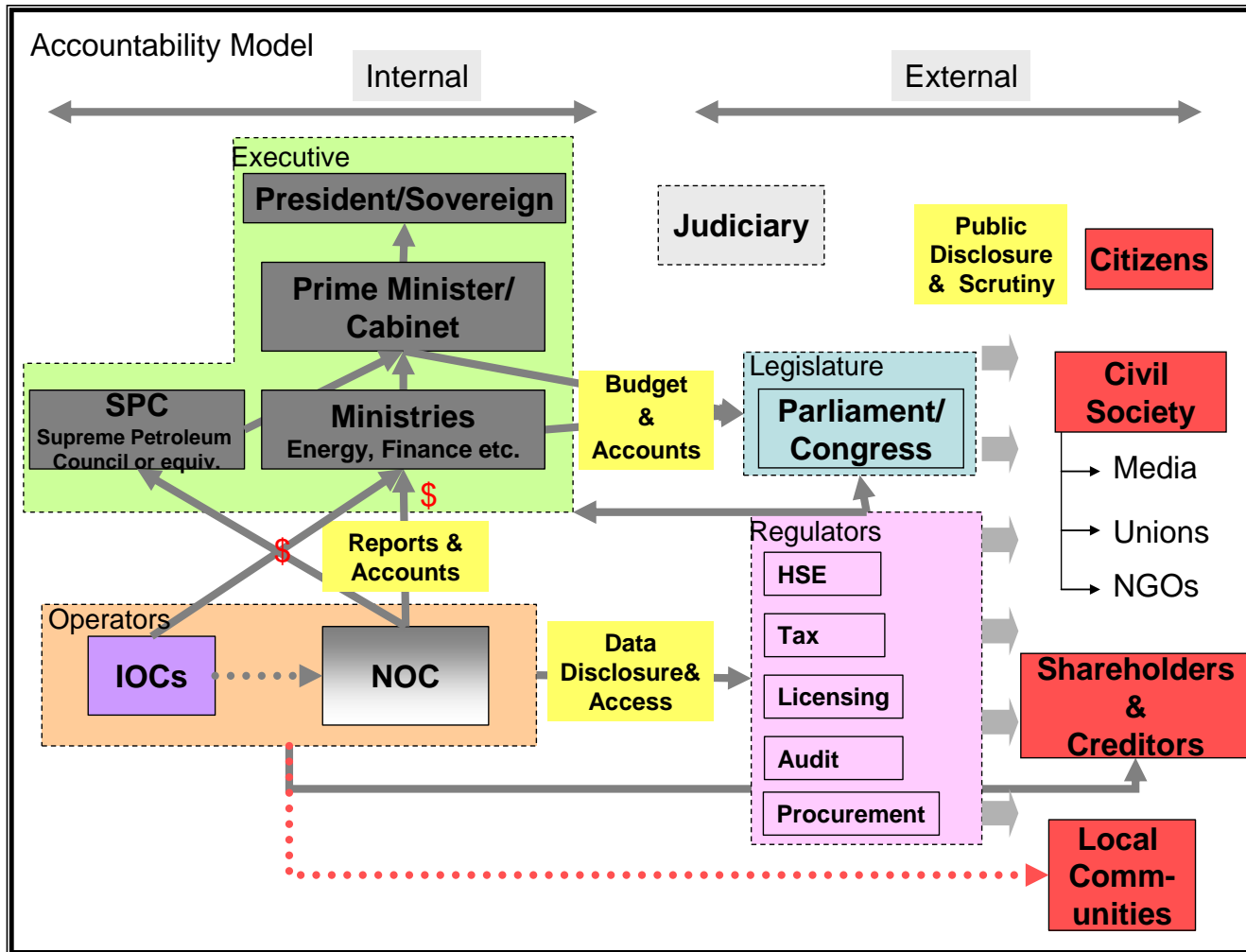
Unitary Board	Non-Executive Board	Executive Board	Two-Tier Board
KPC Saudi Aramco Sonatrach PDVSA Petronas ONGC NNPC?	Statoil Pemex Petrobras	Sonangol	Pertamina NIOC
Strengths Executives supervise operations and non-executives guide policy and ensure accountability.	Strengths Alignment of NOC with shareholder/stakeholder interests. Ensures accountability of NOC executives.	Strengths Strong on knowing what is going on inside the business.	Strengths Separation of policy and strategy in supervisory board from operational performance which is the concern of the operational board.
Weaknesses Performance of the board dependant on the dynamics of the executive-non-executive directors relationship	Weaknesses CEO can become overpowerful if also Chairman. Board can be detached from operational realities	Weaknesses Chances of delivery of fiduciary duty through independent, critical thought is low. Can be weak on monitoring the outside world.	Weaknesses Potential for conflict and competition between the two tiers of board.

Range of Practice

Who is on the board?

How are they appointed?

How is the NOC held to Account?



PETROLEUM REGULATION

Objectives

To understand

- The essential elements of effective regulation
- Different regulatory models and their advantages and disadvantages

Legal and Regulatory Checklist

Constitution



Clear Policies



Enabling
Laws



Enacting
Regulations



License
Agreements



Competent
Regulatory Agencies

Does the constitution provide guidance on Petroleum Governance?

Are Government policies for the sector clear and consistent with the good governance principles?

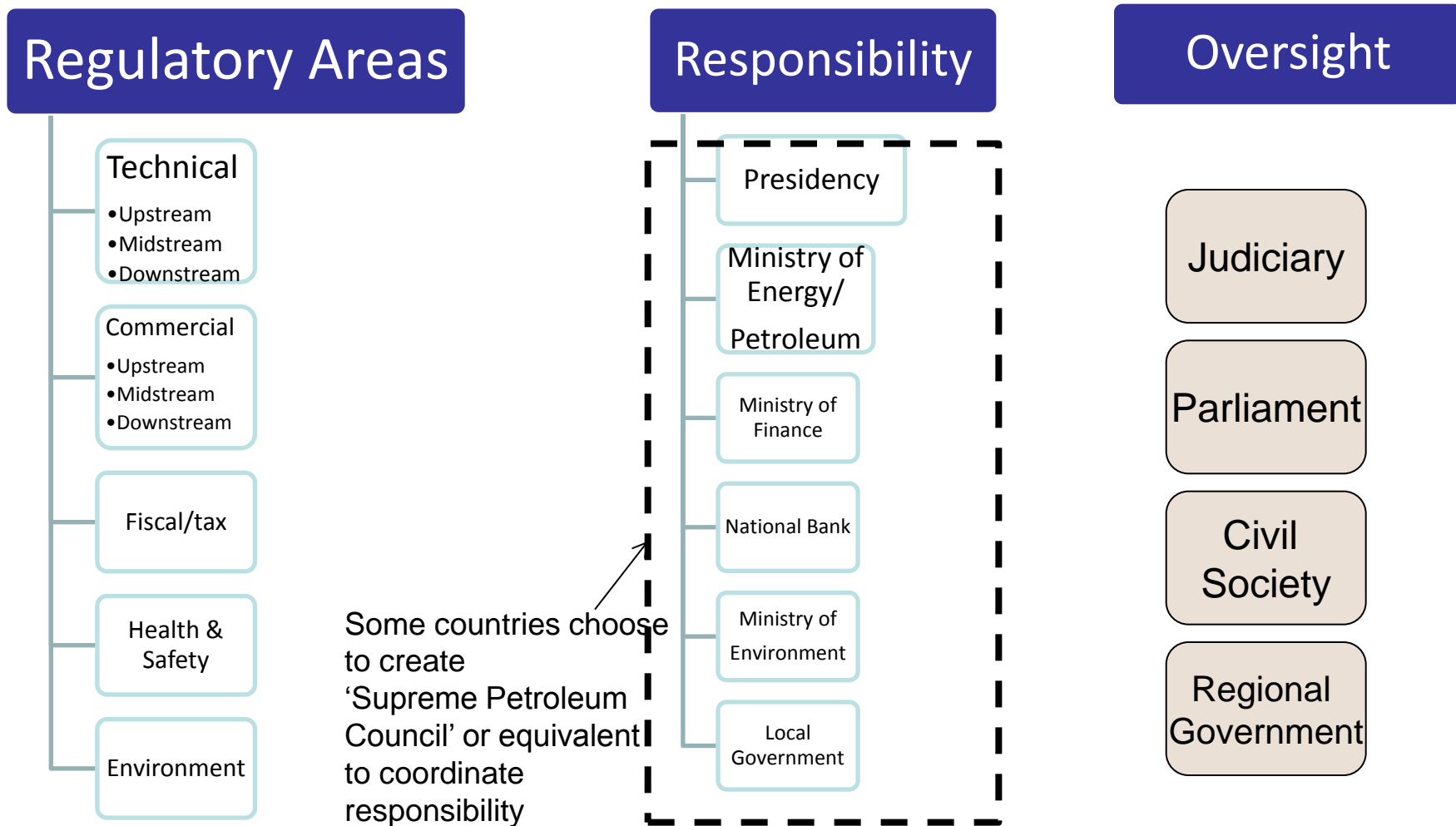
Are the necessary laws in place to enable policy objectives to be achieved?

Has the law been enacted into effective regulation?

Are individual license agreements enforceable and consistent with policy, law and regulations?

Are the systems and institutions in place to monitor and ensure compliance and to achieve policy objectives?

Regulation, Coordination and Oversight



Technical Upstream Regulations Cover Typically

- Licensing
- Prospecting, Exploration and Appraisal Activity
- Development and Production Activity
- Measurement and Lifting of Crude Oil and Gas
- Abandonment of oilfield installations
- Local Content Provisions
- Reporting and Confidentiality

Regulatory Objectives - Government

- License obligations being met
- Expenditure is justified and value for money
- Industry spending maximises national benefits
- Operations being carried out safely with no harm to environment
- National resources are being exploited efficiently
- Government receives the revenues due to it from the production and sale of petroleum under the agreed fiscal regime

Regulatory Objectives – Oil Company

- Legal title
- Respect for contract
- Clear and simple rules
- To operate within the law
- Swift approvals without the need for facilitation (corrupt) payments
- Maximum operational autonomy
- Minimise administration costs
- To adhere to corporate policies and norms

Typical Regulatory Processes

- Pre-activity Approval
 - Approval of work programme and budget
- Monitoring of progress
 - Active risk management
- Post activity audit
 - Audit of outcomes
- Identification and punishment of infractions

An effective regulator needs

- Authority and Mandate
- No conflict of Interest
- Effective Processes
- Capable People

Upstream Regulator – 4 Organisational Models

- NOC acts as regulator
 - e.g. Petronas
- Ministry is regulator
 - e.g. UK
- Separate Statutory Regulatory Body
 - e.g. Norway, Indonesia, Brazil, Columbia
- NOC/Ministry share regulatory functions
 - e.g. Sonangol

Pluses and Minuses of Different Regulatory Models

Regulator Model	+	-
NOC	<ul style="list-style-type: none"> • Strengthens authority of NOC in eyes of IOCs • Technical expertise usually in the NOC 	<ul style="list-style-type: none"> • NOC regulates itself – conflict of interest • NOC decision-making political rather than commercial
Ministry	<ul style="list-style-type: none"> • Regulator close to policy-making • Strengthens Govt control over NOC 	<ul style="list-style-type: none"> • Lack of competent people • Weakens NOC • Regulation overly influence by short term political issues
Independent Agency	<ul style="list-style-type: none"> • Shields regulator from political interference • Able to take a longer term view and build competence 	<ul style="list-style-type: none"> • May not be enough resources for competent NOC and regulator
NOC/Ministry Shared	<ul style="list-style-type: none"> • NOC can retain some leverage over IOCs • Ministry can retain ultimate authority but delegate some tasks to NOC 	<ul style="list-style-type: none"> • Potential for competition between Ministry and NOC • Usually a compromise solution where NOC power is entrenched

Regulatory Checklist

- Have laws been enacted into technical regulations?
- Are capable regulatory institutions in place?
- Is there effective oversight of the regulatory institutions?

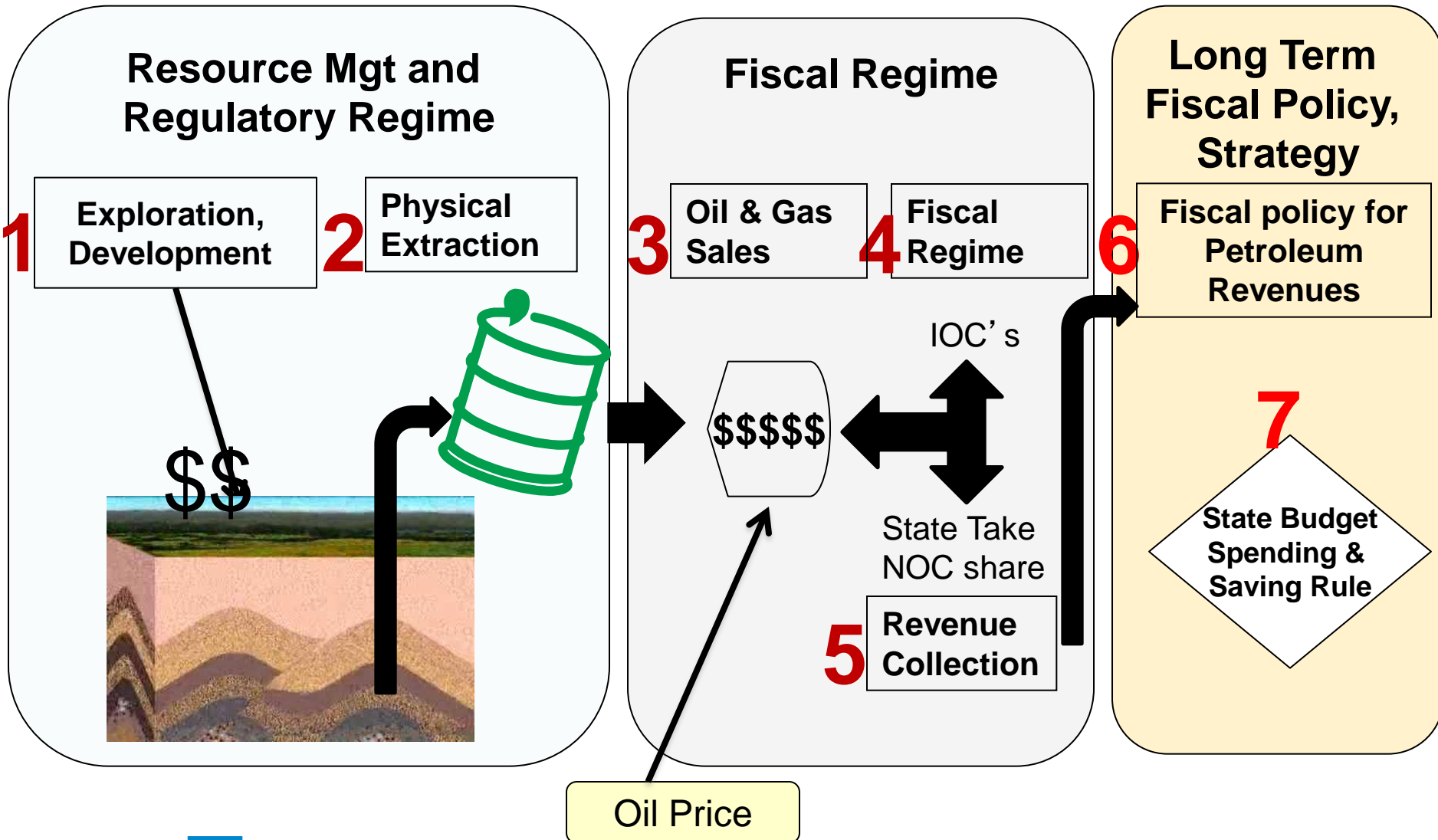
REVENUE MANAGEMENT

Objectives

To understand

- The nature of petroleum revenues
- The challenge of managing the petroleum revenues
- What petroleum funds can and cannot do
- The importance of revenue and budget transparency

Principles of Revenue Management



Fiscal Elements

- Signature & Production Bonuses
- Royalties on Oil & Gas
- State Participation Interest
- Profit Oil & Resource Taxes
- Corporate Income Taxes
- Surface Rental
- Indirect Taxes

Are Petroleum Revenues Different?

- Is it Income?
- Is it a transformation of wealth?
- Should it be treated as conventional tax revenue?
- Is it “free money”?
- How volatile and uncertain a revenue stream is it?

National Hydrocarbon Accounts

UK Oil and Gas	1979	1989	1999	2009
Reserves & Production				
Oil Reserves bn boe	8.8	3.8	5.0	2.8
Gas Reserves bn boe	4.1	3.3	7.4	1.5
Oil Production bn boe	0.6	0.7	1.0	0.5
Gas Production bn boe	0.2	0.3	0.6	0.4
Depletion rate	6%	14%	13%	21%
Gross Revenues £bn				
Oil sales	5.7	7.5	11.0	20.3
Gas sales	0.6	2.2	5.0	6.5
other income		0.5	1.4	1.8
Total Revenue	6.3	10.2	17.4	28.6
Production Costs £bn				
Operating	0.5	2.4	4.5	6.9
Exploration	0.2	1.2	0.5	1.2
Development	2	2.6	3	4.8
Gross Cash Surplus	3.6	4	9.4	15.7
Government Tax Revenue £bn	2.3	2.4	2.6	6.6
Effective Tax Rate	64%	60%	28%	42%
Revenue £/boe	7.9	10.2	10.9	31.8
Costs £/boe	3.4	6.2	5.0	14.3

The Challenges

Unsustainable, Volatile & Uncertain Revenues

- Challenge 1: Choice between spending and saving
 - Saving for what & how to manage it?
 - How much to spend and on what?
- Challenge 2: Insulating government spending decisions from unpredictable revenue shocks?
- Challenge 3: How to share and distribute revenues to producing regions?
- Challenge 4: How to ensure integrity in Government procurement?

Three Critical Policy Choices

1. Fiscal Regime

- Arrangement for Sharing Gross Oil, Revenue Assessment and Collection. **(Steps 4 and 5)**

2. Saving versus Spending Choices

- Determine Annual Budget Funding Amount
- Saving and Investment Guidelines **(Steps 6 & 7)**

3. Spending or Budgetary Choices **(Step 7)**

- Development Plan & Processes

Use & Types of Funds

- **Savings Funds** – *Intergenerational Equity*
- **Stabilization Funds**- *Expenditure smoothing*
- **Hybrid: Financing Funds**
- **There are currently about 25 NRFs in place**

Challenges –

- **Defining the rules for spending/investing**
- **Governance**

Revenue Sharing Issues

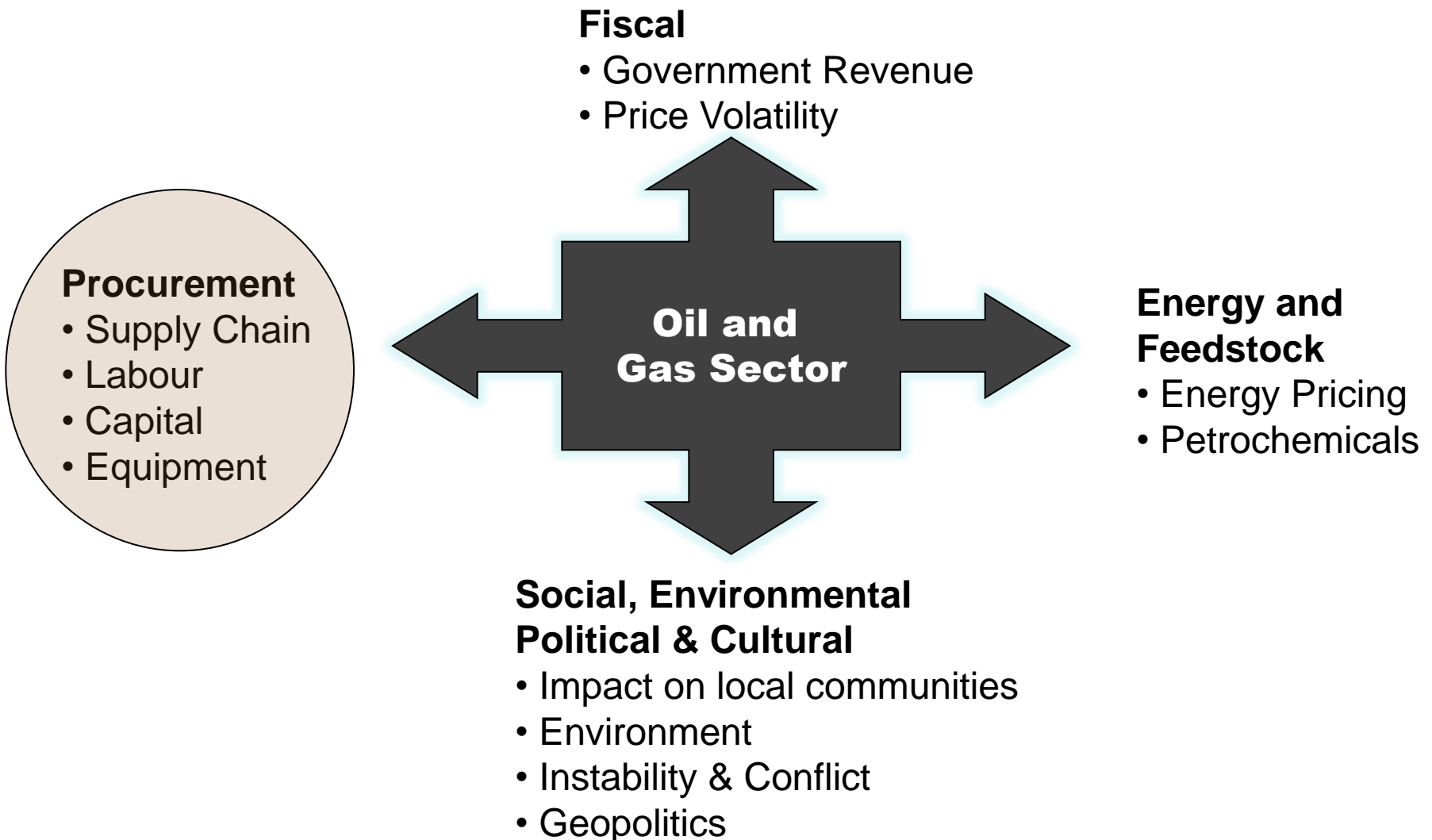
- Political settlement –regional/ethnic rivalries
- Compensate for negative social and environmental costs?
- Reward for ownership rights?
- Establish principles before extraction begins

Revenue Management Checklist

- Are revenue management policies clear?
- Have spending/saving rules been agreed?
- Will revenue and cost transparency allow for effective accountability?
- Does the governance structure for SWF's allow for effective oversight?
- Have revenue sharing rules between central and regional government been agreed?
- Is the government procurement process transparent and have integrity?

LOCAL CONTENT

The oil and gas sector has a significant role in the national development



What is local content promotion?

- Strategies to maximize the benefits from domestic oil and gas development through maximising the quantity of “local content” or “local value addition” in oil and gas sector spending.

Local Content is a means to an end not an end in itself

- The purpose is to increase national wealth through maximizing the macroeconomic and social benefits of oil and gas investment
 - Economic growth
 - More employment of locals
 - Value creation in the country
 - Local Participation
 - Induced expenditure in the local economy
 - Enhanced human capacity
 - Technology transfer

Pitfalls of Local Content Promotion

- Used as a tool for local elite to capture resource rents – ‘briefcase companies’
- Brain drain of local talent into oil and gas sector
- Oil and gas sector creates few jobs – management of expectations
- Jobs maybe temporary if exploration results disappoint
- May lead to higher costs and lower tax take

Successful tools to build local content

- Concession policies and Production sharing contract requirements
- Technology transfer requirements
- Tax incentives
- Procurement & contract strategies
- Support for SME' s and entrepreneurs
- Mentor programs
- Enterprise centers
- Cluster programs & use of tax free zones

What will it take maximize Local Content?

- It requires high Government commitment
- It requires international oil companies to be supportive
- It requires policies and contracts that will allow service companies to invest in the country
- It will require high focus on developing human Resources

Mapping/Identifying Obstacles to LC Promotion 1

- Lack of domestic manufacturing, fabrication and service capabilities to support the oil and gas sector
- Few people with the required skills,
- Lack of adequate power, water and other infrastructure to support an expanded manufacturing base
- Cumbersome bureaucratic obstacles to development of capacities of small and medium sized enterprises

Mapping/Identifying Obstacles to LC Promotion 2

- Underdeveloped capital markets
- Huge proportion imported equipment and expertise must therefore be imported
- Problem of clarity and stability laws and regulations
- Capacity and skills in government
- Fiscal monetary and budget discipline
- Dialogue between government and civil society
- Public sector/private sector Partnership

Local Content Checklist

- Is local content policy consistent with National Development goals
- Are local content goals realistic and sustainable?
- Are local content laws and regulations clear?
- Are measures in place to combat corruption/cronyism?

FINAL THOUGHTS

Final thoughts – future focus?

- Enabling regulatory institutions – technical regulations, access to expertise
- Transparency – National hydrocarbon accounting, budgets, procurement, ownership
- Accountability – Support and strengthen parliamentary committee capacity for oversight
- Sustainability – Embed human rights risk management into business and donor practices